No. 12,814

IN THE

United States
Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA, *Appellant*

v.

P. J. LYNCH, *Appellee*

P. J. LYNCH, *Appellant*

v.

UNITED STATES OF AMERICA, *Appellee*

ON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF WASHINGTON

REPLY BRIEF FOR P. J. LYNCH

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The questions presented to the Court having been heretofore clarified in the prior briefs, as well as the statutes and regulations involved, this brief will serve only to make answer to the fact situation and argument as set forth in the reply brief of the United States.

STATEMENT

With reference to the facts as outlined in the reply brief of the United States, it is felt that some reference should be made to the Statement regarding the potential spoilage and loss of products being stored. It should be

noted that although the Company did attempt to obtain adequate insurance coverage, such was not possible in excess of 30% to 50% of the valuation of the goods stored (R. 42). There was, therefore, actual danger of loss by the Company in the event of product loss.

The United States makes its claim that the Company kept books and rendered income tax returns upon the accrual basis except that storage charges "collectible" were not included until paid. A reading of the transcript shows that various items were kept on the accrual basis; others were kept on the deferred charge basis, and storage accounts were, as stated, only placed on the books at the termination of the storage period for any individual block of fruit or goods (R. 40). The use of the word "collectible" throughout the reply brief of the United States further emphasizes the difficulties encountered at trial. It was and is taxpayer's claim, which cannot avoided, that none of the storage accounts were ever collectible until the fruit or other goods had been removed from the warehouse in satisfactory condition. This is of extreme importance when considered with the applicable law as to when the right to receive income becomes fixed.

Again, the United States recites that the method of handling storage accounts did not preclude correct reflection of income because most of the stored goods had left the warehouse by the end of the fiscal year (Br. 5). It should be noted that this would normally be true as to fruit, but was not true as to the goods being stored under

government contract. As to both the fruit and the government products stored at the Company's warehouse, there was a binding agreement that regardless of the method of computing storage charges, no credit arose to the Company unless and until satisfactory removal (Exh. 4). The storage accounts as of April 29, 1944 were computed to be worth $37,225.96 if all of the storage were removed on that day. However, this was not all government products, but included also fruit being stored.

ARGUMENT

RIGHT OF THE COMMISSIONER TO REQUIRE A DIFFERENT METHOD OF ACCOUNTING

As set forth in taxpayer's initial brief, it is admitted that the Commissioner may require a different method of accounting where the method used by the taxpayer does not clearly reflect income. It appears from the brief of the United States that its contention as to this point is that there must not necessarily be a valid reason for the Commissioner's requirement that the method be changed (Br. 11). Upon the theory that storage accounts were kept on the accrual basis, the right to receive the accounts must first become fixed before the accounts become income. As has been previously shown, there was no right, to receive, fixed and established prior to corporate dissolution. Assuming that the method is a completed contract method, the Company would not be entitled to receive the accounts until the storage contracts had been completed. The sit-

uations are identical as far as the determination of income to the Company.

Much of the United States' brief is composed of a recitation of two cases, *Franklin County Distilling Co. v. Commissioner,* 125 F. 2d 800 (C. A. 6th), and *Jud Plumbing & Heating v. Commissioner,* 153 F. 2d 681 (C. A. 5th). It is claimed by the United States that these cases very closely parallel the instant case. It should be noted, however, that in the *Franklin County* case, *supra,* the corporation had not only accrued the storage accounts on its books, but had also included the same in the tax year involved in the income tax return without filing any claim for refund. The basis for the court's dismissal of the taxpayer company's claim as to the storage charges is clearly identified at the end of the court's opinion as being the election made by the company on which it must continue to stand.

The other question in the *Franklin County* case regarding the state production tax included as a production cost for the tax year, but omitted from the sales price, is of no effect or weight in determining the instant case. The corporation's claim was that the tax, although ultimately to be paid by the holder of the warehouse receipts, would not be collected, by agreement, until the goods were removed from storage. The court, in denying the corporation's claim, clearly indicated that the basis for the denial was the fact that if part of the elements of a sales price are accrued, then all elements of the sales price should be accrued. The tax involved was included in the sales

price of the whiskey, and the Commissioner correctly held, as did the court, that a sales price cannot be segregated by accruing one part thereof and postponing the other to some future date.

General statements of the law in the *Franklin County* case are, of course, correct, but the decision itself adds nothing to the question involved herein.

As to the *Jud Plumbing* case, *supra,* the United States claims that the case is on all fours with the instant case (Br. 11, 14). In that case, of course, the stockholder holding nearly all corporate stock took over all assets and liabilities of the corporation after dissolution, and in doing so, completed certain contracts. These contracts were reported as income by the stockholder as an individual when completed. The Commissioner determined the total cost of the contracts, determined the total profits of the contracts, and then computed, on a percentage basis, the profits up to dissolution date by comparing them with the costs to dissolution date. The court there upheld the Commissioner's ruling, as recited by the United States in its brief. However, there is one point of extreme importance in the *Jud Plumbing* case which completely voids its weight in the instant case. In the *Jud Plumbing* case the corporation, prior to dissolution, not only had the right to receive under its contracts, but had actually received, progress payments on the contracts as the work was being completed. This fact alone shows that the general rule regarding the fixing of the right to receive income had been

satisfied prior to the date of dissolution, and it further emphasizes the absence of such a situation in the instant case.

The United States also seeks to hold (Br. 17) that the corporation is here attempting to obtain a status of no tax liability upon income which should be reported by the corporation as a result of definite action taken by the corporation. The answer to this claim is that the corporation did not have income, and also, the individual stockholders paid a tax on the valuation of these accounts as a capital gain under the liquidation.

We believe that the rule and the decision in *H. Liebes & Co. v. Commissioner,* 90 F. 2d 932, should be given the utmost consideration, and we further believe that although the rules of the *Franklin County* case and the *Jud Plumbing* case, *supra,* constitute the law, the cases are distinguishable on the facts.

CONCLUSION

It is submitted that the decision of the District Court on the storage charges accrual issue should be reversed.

Respectfully submitted,

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